

## **MDP Background Information**

### **MDP I**

At its August 17, 1998 meeting, the Investment Committee approved the concept of a Manager Development Program (MDP I) as a replacement for the then existing Small and Emerging Manager Program. The concept of the Manager Development Program is to provide venture capital and investment funds to emerging firms in exchange for a significant but minority equity stake in the selected firms.

At its October 19, 1998 meeting, the Investment Committee: (1) approved a partnership structure for the MDP I in which the partners were solely responsible for manager selection and staff, along with the partners, were responsible for ongoing monitoring of managers selected for the program by the partners. In addition, the Investment Committee authorized staff to begin a focused solicitation process to select the external partner(s) to implement the program.

On May 20, 1999, the Investment Committee interviewed three firms and selected Strategic Investment Management and Progress Putnam Lovell as partners for the MDP I. Progress Putnam Lovell was a joint venture of Progress Investment Management and Highcrest California Partners (a subsidiary of Putnam Lovell NBF). In addition, the Investment Committee approved an allocation of \$2 billion to Strategic Investment Management and an allocation of \$1 billion to Progress Putnam Lovell.

Limited liability company agreements were finalized with both partners for both the venture and investment assets in April 2000. CalPERS committed \$40 million in venture capital funds for the Strategic Investment Group Ventures, LLC. Strategic has allocated \$9.3 million in venture capital among eight managers. In addition, CalPERS committed \$2 billion in investment assets to Strategic Investment Group Investments, LLC. Strategic allocated \$1.7 billion among eight managers.

CalPERS also committed \$40 million in venture capital to Progress Putnam Lovell Ventures, LLC. Progress Putnam Lovell Ventures, LLC has allocated \$22.2 million among eight managers. In addition, CalPERS committed \$1 billion in investment assets to Progress Putnam Lovell Investments, LLC. Progress Putnam Lovell Investments, LLC allocated \$850 million among eight managers.

In 2004, Highcrest California Partners (a subsidiary of Putnam Lovell NBF) reorganized into a new independent company, Lovell Minnick Partners LLC. The new firm is the successor to the private equity business formed in 1999 by Putnam Lovell co-founder Jeffrey D. Lovell. The restructuring provided Lovell Minnick with greater independence and freedom from concerns about conflicts of interest with Putnam Lovell's other activities. Lovell Minnick Partners retained all employees working previously under Putnam Lovell Capital Partners. As a result of this transaction, the Progress Putnam Lovell partnership was renamed to Progress Lovell Minnick in 2005.

The term of the MDP I is seven years with the option of up to five one-year extensions. The MDP I investment period had a three year time frame, ending in May 2003, which was extended six months. The MDP I reached its seventh year in May 2007, however staff has exercised two one-year extensions.

The investment charters for the MDP I partners permitted investment in small and emerging investment management companies with less than \$2 billion under management, whose primary investment focus is in public equity and fixed income markets, and whose primary market focus is institutional clients. The limit on assets under management was increased from \$1 billion to \$2 billion by the Investment Committee at its February 19, 2002 meeting. This change increased the investment universe of firms that are California based and have independent ownership and/or women/minority ownership.

The investment charters prohibited investments in firms managing real estate, commodities, natural resources, or other non-financial assets.

As noted above, since the inception of MDP I, two managers have been transitioned from MDP I to CalPERS' mainstream external manager program. Arrowstreet Capital Management transitioned from the Progress Lovell Minnick portfolio in February 2003 and manages \$1.1 billion for CalPERS as of April 30, 2008. Golden Capital Management transitioned from Strategic's portfolio in March 2007 and manages \$496 million for CalPERS as of April 30, 2008.

## **MDP II**

In August 2004, the Investment Committee voted to expand and improve the MDP through the creation of a follow-up program called MDP II. Unlike MDP I, MDP II has an open-ended, opportunistic investment period rather than a fixed term. MDP II has the following additional enhancements: 1) MDP II Partner management fees paid on invested capital rather than on committed capital, 2) there is no specific commitment of CalPERS' capital to the program, and 3) both staff and MDP II Partner must agree on each investment.

In June 2005, staff presented to the Investment Committee the results of the search for MDP II program advisors. Five firms were selected for a spring-fed pool. In February 2006, staff provided an update to the Investment Committee that contracts had been executed with the five firms who had been selected but that limited liability agreements were being negotiated with just two of the advisors: Legato Capital Management and Strategic Investment Management, both of whom specialized in long-only strategies. Of the three remaining firms in the spring-fed pool, two specialized in emerging hedge fund-of-funds only, and one of these has since gone out of business. The third remaining firm, a joint venture, decided to dissolve its joint venture partnership and was removed from the MDP II spring-fed pool of advisors. The Investment Committee was notified of the dissolution and removal on February 20, 2007.

On March 1, 2007, the first MDP II firm was funded. Two additional firms were funded in February and March 2008. In addition, in March 2007, the Investment Committee approved the addition of Lovell Minnick Leading Edge Advisors (LMLE), a joint venture between Lovell Minnick Advisors and Leading Edge Advisors, to the spring-fed pool of MDP II advisors. Although the contract with LMLE was completed in 2007, negotiations for the limited liability company agreements continue. The negotiations have been put on hold on more than one occasion as one of the joint venture partners has been uncertain as to whether it wishes to complete the negotiations given its other business priorities. A final decision on this matter is expected by June 30, 2008.

At its May, 2007 meeting, the Investment Committee approved an amendment to the MDP II partners' investment charters to expand the permitted investment to include those strategies that are externally managed in CalPERS public markets programs, excluding hedge funds and funds of emerging hedge funds.